TEACHERS' RETIREMENT SYSTEM OF THE STATE OF ILLINOIS

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News

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TESTIMONY OF TRS EXECUTIVE DIRECTOR DICK INGRAM TO THE HOUSE PERSONNEL AND PENSIONS COMMIUTTEE

SPRINGFIELD, IL – Attached is the testimony of TRS Executive Director Dick Ingram before the Illinois House Personnel and Pensions Committee regarding House Bill 4427 and House Bill 5625.

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About Teachers' Retirement System

The Teachers' Retirement System of the State of Illinois is the 39th largest pension system in the United States, and provides retirement, disability and survivor benefits to teachers, administrators and other public school personnel employed outside of Chicago. The System serves 400,000 members and had assets of $43.7 billion as of December 31, 2015.

ILLINOIS HOUSE PERSONNEL & PENSIONS COMMITTEE
MARCH 10 2016
STATEMENT BY
RICHARD W. INGRAM
EXECUTIVE DIRECTOR, TEACHERS' RETIREMENT SYSTEM
RE: VARIOUS PENSION BUYOUT BILLS

Good morning Madame Chair and members of the committee.

Thank you for the opportunity to speak during these subject matter hearings on the bills that would create buyout options for members of the state funded pension systems.

For the record, my name is Dick Ingram.

I am the Executive Director of the Teachers' Retirement System.

TRS is the largest of the state funded systems.

We represent teachers and other professional staff in school districts throughout Illinois, with the sole exception of Chicago Public Schools.

We have nearly 400,000 active, retired and inactive members who work and live in all 102 counties throughout Illinois.

The annual benefits that we pay are approaching $6 billion, most of which stays in Illinois, making us the provider of what arguably may be the largest annual payroll in the state.

We manage approximately $45 billion in assets. Our accrued actuarial liability for benefits earned is approximately $108 billion, which means that we are only 42 percent funded.

Fully funded we would be the 7th largest system in the country, as measured by assets under management.

I offer my comments fully aware of the extreme fiscal challenges that the State of Illinois faces.

I do so in the spirit of continuing to be the honest partner that TRS has been with you for the last five years.

Hopefully we can agree that while the pension debt that burdens our state finances is a very visible symptom of Illinois' systemic fiscal failures, it is not the cause.

Together with our newly appointed actuaries at Segal Consulting -- the same firm retained by COGFA -- we will work closely with you in whatever way you deem helpful.

I will speak to both bills in general terms and not specifically to either.

My goal is to share broad observations and concerns, while measuring expectations about what the proposals may accomplish.

Using our current fiscal position as a starting point, we will likely find that any buyouts will have minimal impact on the $108 billion liability that already exists at TRS, which is the problem that we are all concerned with today.

Increases in our liabilities that accrue in the future may be reduced by these proposals, but you won't see any significant relief for the unfunded burden on the books today.

In fact, buyouts may actually serve to accelerate the state's pension obligations, albeit at a reduced rate.

WHAT VALUE MIGHT RESULT FROM THE PROPOSALS?

I am pleased that neither of the proposals look to the pension systems to fund any buyout.

TRS has no funds available for that purpose if they did.

As I noted above, our current funded status is roughly 42 percent, which certainly helps explain your interest in legislation such as this.

We have roughly $45 billion in assets to pay off some $108 billion in accrued liabilities.

Some additional details are pertinent to this discussion.

Of the $45 billion we manage in assets, roughly $10 billion is the contributions made by our members.

Those are only available to pay the benefits that those members have earned.

We must set them aside for that purpose.

The remaining $35 billion is available to fund benefits for all members.

What is sobering is that some $70 billion to $75 billion of our total accrued liability is owed to our retired members.

You can quickly see that the $35 billion of assets available to pay benefits covers less than half of what we owe to our members who are already retired.

Those benefits should be fully funded when the member retires.

They are not now and never have been.

Further, there are no assets in the trust available to pay future benefits for active members.

Every dollar of earnings goes towards filling the funding shortfall for retired teachers. Active member benefits should also be fully funded as they are earned.

They never have been.

The majority of the remaining $30 billion liability is related to the service of our older late career active members.

The smallest piece of the active liability on the books today pertains to our mid-career and younger members.

This is significant when considering the context of the bills you are considering.

BUYOUTS ARE A BENFIT CUT

Second, it must be stated that any buyout -- whether it be full or partial, at retirement or before, rolled over into an IRA or used to purchase an annuity -- is a reduction in the guaranteed benefit that the member may have earned up to the point of the buyout.

While the proposals may have a certain appeal to some, and potentially positive perceived benefits, we should study carefully as to whether we might expect any significant benefit from them.

I can see few instances where prudent financial considerations would lead a member to take a reduction in a benefit that has been guaranteed by the Illinois Constitution and reaffirmed by the Supreme Court.

Such instances would be rare and likely due to unusual personal circumstances.

They will likely often reflect what is termed adverse selection.

An example would be a member who has a terminal illness and who can determine that the lump sum will provide a bigger payout than the monthly benefit.

Further, accepting a buyout would place the members' assets subject to the well documented reality that individuals personally managing their retirement money in an IRA or defined contribution account do so with lower average annual investment returns and higher costs than when their assets are managed professionally in a pooled defined benefit plan that shares risks and rewards.

Some have pointed out that an individual account can be willed to your heirs when you die.

That is true but when that happens it means you have lost the longevity lottery and died early.

I would also note that the survivor benefit available to a member of TRS allows them to provide for their beneficiary after they die.

While not exactly analogous to the passing on of an asset like the remaining balance of an IRA, it is a significant value when a member is planning for the financial security of their loved ones after they die.

Others have stated that having control over their assets after a buyout would provide a member some financial flexibility.

True again, but this is flexibility that many if not most of our members would likely not need.

It would also subject the funds to the risk of being diverted to some non-retirement use.

Their TRS benefit is the core element of their retirement security.

They are teachers who have planned their retirement relying on a defined benefit that is designed to replace roughly 75 percent of their full-career, pre-retirement earnings.

This is exactly what most financial planners suggest is prudent.

While they may supplement their defined benefit with personal savings in some manner, they have not earned any Social Security benefits that provide a retirement safety net for most of their friends and neighbors.

They need the security of a regular monthly check that their TRS defined benefit delivers.

A MATTER OF TRUST

This brings us to a critical point.

There has been discussion in the early consideration of these bills that our members will see this as a chance to get out from under the mistrust they feel for the state, to “stop being a political football”.

Let's be clear.

We know that our members trust TRS. A recent member survey proved that without a doubt.

They know we are well-managed and delivering exceptional member service, despite operating under the most challenging circumstances in the business.

They rely on the outstanding investment returns that we have earned for them over long periods of time.

Our most recent 30 year returns average 9.1 percent. They know that they and their friends and neighbors would likely not have earned that kind of return in a 401K over the last 30 years.

It is interesting to note that whenever a Defined Contribution proposal is discussed in the legislature our members always want a "TRS Option" for the plan...they want to be able to invest their supplementary savings with us as well.

It is the General Assembly our members do not trust.

The same survey also revealed – loud and clear – that they are suspicious of any proposal originating in the General Assembly designed to solve the financial problems facing TRS.

They, along with their friends and neighbors, as well as editorial boards and think tanks, understand that decades of underfunding by state government created the financial burdens of today.

Frankly, they do not like the fact that they are continually being singled out to shoulder the burden of fixing the problem.

They paid – and do pay – 100 percent of the contributions they are required to make.

They believe it is unfair that they should sacrifice the promises made to them years ago about their retirement in order to undo the mistakes of the people who made those promises.

To illustrate what that means, the TRS appropriation for FY2016 is over $3.7 billion.

Only some $800 million of that is for the cost of pensions being earned this year.

The balance – nearly $3 billion – is what must be paid by taxpayers to replace a small portion of the investment earnings we were not able to earn over recent decades because of the billions we were under funded and did not have available to invest.

Imagine if we had been properly funded through the years and only required an $800 million appropriation this year.

Could you find a use for that extra $3 billion?

Comparisons have been drawn between these proposals and pension buyout options that have been offered in the corporate world.

Those comparisons are disingenuous.

The rules governing corporate pension buyouts require a 100 percent payout, not 75 percent, and the lump sum must be calculated using a much lower rate, currently in the range of 4 percent.

This dramatically increases the cost of the buyout.

Corporations can also go out of existence and dodge their pension promises in a variety of ways.

Members of my own family experienced that harsh reality.

That is why a buyout now when weighed against an uncertain future benefit may be very appealing in the private sector.

Contrast that with our members who have a benefit that is constitutionally guaranteed and affirmed by the Supreme Court.

Why would they give that up?

The only reason they might is if they fear for the state’s ability to make good on its promises to fund these pension obligations.

I would hope that these proposals are not a back door attempt to renege on the states obligations or to try and buy our members out without coming clean on what the real intent is.

TRS has a fiduciary obligation to its members that they all be treated equally -- at least within their respective tiers -- and we would want to be sure that the same options are available to all our members, not just a few.

Holding out the threat of some future taking of their benefits as an incentive to take a buyout is misguided.

Any buyout would apply only to the benefit earned up to the point of the buyout -- not to some hypothetical future constitutional amendment and reduction of future benefits.

A member would face very different choices under such a scenario.

THE QUESTION THAT IS NOT BEING ADDRESSED

What is not addressed by this and other pension proposals?

Four years ago this month I posed a question to the TRS board. It was in the context of a broader discussion about the future solvency of TRS.

Many of you may remember the attention some of my questions attracted. But the key question that I asked remains unanswered.

WHAT DO WE DO IF NOTHING HAPPENS?

Four years later nothing has happened.

Not for lack of trying certainly, and thanks in part to going through the process of having the Supreme Court clarify the legal boundaries you must work within when addressing this problem.

But the fact remains nothing has happened to address the core financial issues facing the state and that contribute to the funding challenge at TRS.

These proposals may have some merit.

TRS is committed to be an honest broker of the information and analysis that will inform your policy making as you consider their merits.

But this proposal and other discussions that have been floated do not get to the core issues of a structural state budget imbalance and the flawed statutes governing TRS.

Let me wrap up by briefly mentioning two opportunities that would be important steps towards getting the statutes governing TRS right.

First, state law still requires that we use what TRS has dubbed "Illinois math".

The Pension Code does not allow us to use true actuarial methods when calculating the required annual contribution.

What would be so hard about adopting actuarial funding principles, calculating the proper actuarially based funding amount each year, and if not able to fund that full amount to merely say so?

This would be more transparent and honest than patting ourselves on the back for fully paying a contrived number.

That is why TRS certifies two annual contributions for you.

The statutory amount that you pay and the actuarial amount that you should pay.

You need to know the truth.

Second, five years after it became effective the structural flaws of Tier II remain to be addressed.

While there were certain virtues to the Tier II changes, the flaws in executing them have created a large and growing inequity.

Tier II members overpay for their benefits by nearly 30 percent. This is in essence a tax that only Tier II members pay and it subsidizes the states' obligation to make good on prior funding shortfalls by some $20 billion over time.

It is galling that nothing is being done to address this, despite the fact that most everyone acknowledges it exists and especially when other proposals discussed from time to time speak of the need to lower Tier I contributions while ignoring Tier II.

We would be particularly happy to work with you on solutions to this problem.

Thank you for the time you have given me.

I look forward to working with you on solutions to provide true financial stability to the state pension systems.

I am happy to answer any questions.